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DEPARTMENT OF THE AIR FORCE
HEADQUARTERS UNITED STATES AIR FORCE
WASHINGTON 25, D. C.

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REPLY TO:

Auditor General
Comptroller, USAF
Hq Western District
1206 Maple Avenue (Room 916)
Los Angeles 15, California

4 August 1958

SUBJECT: Accounting Review of Termination Settlement Proposal (Interim)
Relating to Item 10 of Contract FL-3011, Partially Terminated
as of 10 October 1956
Westinghouse Electric Corporation, Air Arm Division
Baltimore, Maryland

REF: Document No. 26759, 29 April 1958

TO: Contracting Officer

1. An accounting review has been made of the contractor's termination settlement proposal (interim) submitted on the inventory basis. The amount of the proposal is \$62,029, and reflects no disposal credits or advance progress, or other payments. The review consisted of the analysis of the contractor's own charges of \$58,071, before the addition of profit of \$3,958.

2. The contractor's accounting records were examined and selective tests were made of accounts and supporting records. The contractor's own charges, before inclusion of a variance adjustment, general and administrative expense, and settlement expenses, are in the same amount as costs relieved in the records for the continuing portion of Contract Item 10.

3. The indicated effective date of termination in the proposal, 10 October 1956, is the date of Contracting Officer's letter confirming verbal advice on 28 September 1956, that requirement no longer existed for 2 of the 13 equipments called for under Item 10 of the contract. At that time it was visualized that the residue parts would be applied to a spare-parts contract item. However, it was found that not all of the parts were applicable to spares, and therefore resulted in the termination inventory. (Reference Contract Amendment No. 7)

4. At the time of the audit, no Statement of Allocability had been received from the Contracting Officer. For this reason, the auditor's recommendation in the succeeding paragraphs is subject to such verification of the inventories as is deemed necessary by the Contracting Officer with respect to allocability, count, and stage of completion, technical requirements and divertibility. The auditor was informed that the inventory included some residue material pertaining to non-technical contract items, including the remaining 11 systems.

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5. The following recommendations with respect to the items reviewed are submitted for the guidance of the Contracting Officer:

<u>For Acceptance (See paragraph 10)</u>		\$ 43,266
<u>For Non-acceptance</u>		
Purchased parts (paragraph 6)	\$ 584	
Miscellaneous (paragraph 7)	300	
General & Administrative Expense (paragraph 8)	<u>1,099</u>	1,983
<u>For Further Consideration</u>		
Purchased parts (paragraph 6)	7,270	
General & Administrative Expense (paragraph 8)	<u>5,052</u>	
	\$ <u>12,322</u>	
Settlement expenses (paragraph 9)	<u>500</u>	<u>12,822</u>
Contractor's Own Charges, Items 10 and 12 of Settlement Proposal		<u>\$58,071</u>

6. Recommendations as to Purchased Parts:

a. For Non-acceptance - \$584: This amount represents eight crystal units withdrawn from the termination inventory and diverted to other work. The contractor's representative concurs with this recommendation.

b. For Further Consideration - \$7,270: This amount represents the items of purchased parts listed on page 6 (of 6) of the contractor's termination inventory, Schedule B. Inasmuch as there was stated to be a continuing requirement for these items, and it is understood that the contractor plans to divert them to other work, this amount is recommended for the further consideration of the Contracting Officer.

7. Recommendation as to Miscellaneous Costs:

a. For Non-acceptance - \$300: This amount comprises the following items:

- | | |
|--|--------------|
| (1) Excessive amount of variance applied to factory labor and overhead | \$700 |
| (2) Cost of one additional compressor (Item 19, page 5 of 5, Termination Inventory, Schedule B), excluded from original schedule, and being transferred to the termination inventory | <u>400</u> |
| Total Recommended for Non-acceptance | <u>\$300</u> |

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8. Recommendations as to General and Administrative Expense:

a. Special Comments: The contractor claimed a full general and administrative expense rate of 17%, and applied this rate to the total of purchased parts and miscellaneous costs. In the opinion of the auditor, a full general and administrative expense rate should not be applied due to the disproportionate amount of material costs included in the proposal. The auditor's full rate of 15% has therefore been applied only to the processing costs and that portion of the total material costs which is considered not to be disproportionate. The amount of general and administrative expense resulting from the application of the auditor's rate of 15% to the disproportionate amount of material costs is recommended for further consideration (paragraph 8c). It is believed that this procedure provides the means for more equitable measurement of general and administrative type expenses related to material procurement.

b. For Non-acceptance - \$1,099: This recommendation for non-acceptance consists of the following items:

- | | |
|---|------------|
| (1) Purchased parts (\$584) and miscellaneous costs (\$300) totaling \$884 recommended for non-acceptance at contractor's rate of 17% | \$ 150 |
| (2) Difference between contractor's rate of 17% and auditor's rate of 15%, or 2% of: | |
| \$7,270 costs recommended for further consideration | 145 |
| \$40,181 costs recommended for acceptance | <u>804</u> |

Total Recommended for Non-acceptance	<u>\$ 1,099</u>
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c. For Further Consideration - \$5,052: This recommendation for further consideration consists of the following items:

- | | |
|--|--|
| (1) \$7,270 costs recommended for further consideration at auditor's rate of 15% | \$ 1,091 |
| (2) Purchased parts and miscellaneous costs recommended for acceptance in the amount of: | |
| Less: Proportionate costs | <div style="display: inline-block; text-align: right;"> \$40,181
 <u>13,775</u>
 \$26,406 </div> |
| \$26,406 at auditor's rate of 15% | <u>3,961</u> |
| Total Recommended for Further Consideration | <u>\$ 5,052</u> |

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d. Reference is made to paragraph 3a of supplement to report on price redetermination audit for Contract Items 7 and 10 through 15, in regard to the auditor's general and administrative expense rate.

9. Recommendation as to Settlement Expenses:

a. For Further Consideration - \$500: The contractor included \$1,519 in its proposal as representing the cost of settlement expenses applicable to the customer's partial termination. It is the auditor's estimate that \$500 of this amount pertains to the contractor's cancellation of its own two units.

10. Special Comment: The auditor's recommendation of \$43,266 for acceptance is subject to consideration by the Contracting Officer of the following:

It was noted during the review that the contractor terminated its portion of the following purchase orders in the amounts shown:

<u>Purchase Order No.</u>	<u>Vendor</u>	<u>Amount</u>	<u>Amount in Termination Inventory</u>
86 CC 96111-S	Specialties, Inc.	\$ 20,029	\$ 20,036 (Note a)
86 CC 97182-S	Great Lakes Mfg. Co.	1,800	900 (Note b)
86 CC 97181-S	Great Lakes Mfg. Co.	800	800 (Note c)

Notes:

- (a) Termination charges for cancellation of the customer's portion, stated in vendor's letter of 30 October 1956, would have been \$16,781, had termination been effected at that time. However, termination instructions were not transmitted to the vendor by the contractor, resulting in completion of the customer's two units and the resulting increase in delivered cost of \$20,036, as listed in the termination inventory schedule.
- (b) The contractor terminated its portion of these purchase orders without & incurring termination charges. It is not known that a no-cost termination would have resulted from the cancellation of the customer's two units.
- (c) tion would have resulted from the cancellation of the customer's two units.

The auditor did not ascertain whether the contractor, in permitting completion and incurrence of the additional cost of the customer's two units, was acting in accordance with the instructions or consent of the customer.

11. Although the termination claim was submitted as an interim proposal, it was represented as including all costs except for an increase in settlement expense. The proposal is subject to reduction for disposal credits, depending upon disposition of the termination inventory.

Project Supervisor
Western District
Auditor General